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ICPS newsletter

John Tedstrom: Good Economics is Good Politics

John Tedstrom, senior economist at Rand Corporation was in Kyiv from January 21 till January 26. Rand is a leading American think tank active in national security, foreign and internal policy. It fulfils joint projects with the International Center for Policy Studies—Centers for Policy Excellence and European Choice.
Mr. Tedstrom agreed to provide his comments on the relations between Ukraine and international financial organizations for the ICPS newsletter.

How do you evaluate the chances for restoring collaboration between Ukraine and the International Monetary Fund and the World Bank?

No doubt, Ukraine has a good opportunity to receive support form the IMF and the World Bank. These organizations have expressed their commitment to Ukraine's future. Yet their positive decision depends on Ukrainian leadership now. The Ukrainian government has taken important reform measures over the course of the last few months. Ukraine and the IMF are now on the final stages of reaching an agreement but the Ukrainian government will have to take several additional steps to secure its conclusion.

What shall Ukrainian government do to secure the agreement with the IMF?

The main step to restoring financial aid was the passage of the 1999 budget built on a framework of responsible economic forecasts. Also important is the implementation of the public administration reform program.

Why is it important?

The public administration reform is important because the current bureaucratic system promotes bad decision making, impedes reforms and economic growth. On the other hand it promotes inefficiency and corruption.

What steps must this reform comprise?

It has to include reduction of the number of government agencies and bureaucrats; change of the success criteria for Ministries and State Committees—they should be responsible for making and implementing policies that provide for economic development, new jobs, low inflation and efficient use of resources so that Ukraine becomes a full-European country. In other words, Ukrainian state officials must put national interest over personal interest while just the opposite is the case in Ukraine today.

Is it realistic to expect such measures in the near future?

Yes, most of the steps can be taken by the government within next four weeks.

But will the reforms continue after that?

One should remember that the IMF's Extended Finance Facility (EFF) is a three-year program. It stipulates that Ukraine will take certain measures during the years of its implementation. The IMF officials will observe and support Ukraine's progress in taking all the measures provided for in the agreement on the EFF. If Ukraine meets all the requirements the IMF will disburse the next tranche.

Can financial support from the IMF and the World Bank help avoid the default on Ukraine's sovereign debt?

The volume of the support will be enough to avoid default on external liabilities. Besides that, success with the EFF is important to Ukraine for two additional reasons. First, it is important for domestic reasons—reforms make lives of the people of Ukraine better. Secondly, it allows Ukraine to distinguish itself as a reliable international player. Other countries that defaulted on international obligations have become isolated. Ukraine must not repeat their mistakes.

What do you think about the possibility of the following scenario: Ukraine joins the Union of Russia and Belarus and this coalition shuts off from the rest of the World?

Last week

Economic Forecast for 1999 Remains Pessimistic. The macroeconomic seminar held at the International Centre for Policy Studies on January 19 saw the Quarterly Predictions experts disclosing their preliminary economic forecast for the year 1999. The economists presented two scenarios of the development of Ukrainian economy — an optimistic scenario and a pessimistic one each of which had a probability of about 50%. According to the optimistic scenario Ukraine will receive external financial support which will allow Ukraine not to default. The pessimistic scenario envisages Ukraine's default on the sovereign debt. Chief economist of the ICPS and head of the Quarterly Predictions team Mr Vasyl Yurchyshyn described the probability of reforms as negligible.

Absence of market reforms of the national economy removes the economic growth from the 1999 agenda — both scenarios provide for the decline in real GDP: the optimistic one –3.5% and the pessimistic one –6%. Should Ukraine receive external funding and preserve its strict monetary policy inflation will grow by 20% YOY in 1999 and the hryvnia–dollar exchange rate will be 4.25 UAH/USD as at the end of 1999. The pessimistic scenario forecasts Ukraine's default on foreign and domestic debt which will lead to unrestricted growth of money supply, hyperinflation and the hryvnia debacle. Under these circumstances inflation will be 40% YOY and the exchange rate — 6.00 UAH/USD as at the end of 1999.

Policy towards Money Laundering. The International Centre for Policy Studies hosted a round table discussion of money laundering issue on January 21. The round table was held within the joint project of Ministry of Justice of Ukraine, the US Embassy in Ukraine and the International Centre for Policy Studies.

This week

Macroeconomic Seminar on Paralysed Enterprises. The macroeconomic seminar on Tuesday, January 26 will be devoted to the subject-matter of the first issue of a new monthly publication of the ICPS — the Policy Studies — Paralysed Enterprises. The authors of articles included into this issue of the Policy Studies analysed the problem of restructuring of Ukrainian enterprises and macroeconomic consequences of existence of noncompetitive and unliveable enterprises in Ukraine.
The ICPS economist Mrs Inna Lunina and Mr Serhi Ilchuk will deliver reports based on their articles in the Policy Studies at the seminar. The following questions will be discussed:

1. Existence of unrestructured enterprises threatens the stability of Ukrainian state finances. Forms of state support of soft budget constraints of enterprises.
2. Good and bad debts of enterprises. Economic difference between enterprises' mutual arrears, debt to the budget and payroll indebtedness. The government's role in the non-payment crisis.
3. Monopoly rent of directors. What impedes reforms at micro-level? Can privatisation accelerate structural changes at enterprises?

This is impossible. No president, no MP of Ukraine, wants to preside over the disappearance of Ukraine's statehood. The question is not whether Ukraine will stay independent but what kind of state Ukrainians will build for themselves. Ukraine can return to the past or continue the process of *desovietization* and reemerge as a rich European country.

What mistakes have the West and Ukraine made in their relations?

Both Ukraine and its Western partners had long-term goals but short-term strategies. The West and Ukraine failed to build public understanding of the necessity of reforms, explain the costs and benefits to the Ukrainian people—this was a strategic mistake.

Can it be corrected?

Absolutely! We have to think about public education, *"prosvita"* in order to embed European values into Ukrainian society, these values being democracy, rule of law and free market economy. The lesson Ukraine learnt during last years is that European integration is not the job of the Ministry for Foreign Affairs—it is rather the job of the Ministry of Finance, the Ministry of Economy, the Ministry of Justice, the Ministry of Foreign Economic Relations, the Ministry of Labor etc.—i. e. the question of domestic transformation towards European economic and social standards.

But many people consider reforms a bad political decision, especially when elections are coming. Do you agree with this?

No! Good economics is good politics. Political leaders who implement reforms which improve the lives of the citizens will undoubtedly be rewarded with political support of the electorate.

Is there a consensus in American establishment towards the issue of expediency of rendering support to the countries of the former Soviet Union?

The common opinion is that as long as Ukraine is pursuing a reform agenda financial support does make a positive difference. The problem with Russia is that international lenders feel that their money will not be put to good use and they take decisions based on that understanding.

The IMF mission is working in Kyiv now in hopes of restoring cooperation with Ukraine. This is a proof of the commitment by the international community to the goal of economic recovery in Ukraine.

Policy of European Social-Democrats Barriers Ukraine from the EU

Hopes of many policymakers and citizens of the countries of Central and Eastern Europe for swift accession of their countries to the European Union can well become sour. Beside traditional obstacles as economic problems and low levels of per capita income, a new barrier can arise from the economic policy of leftist governments of the EU states, first of all in Germany. Such a conclusion was articulated by Mr Peter Gowan of the University of North London during the seminar on Ukraine's integration into the EU held at the International Centre of Policy Studies on January 21.

It was widely believed that social-democratic parties of West European countries were much more enthusiastic about the EU enlargement than the conservatives — the Tories in the UK and Mr Kohl's Christian-Democratic Union in Germany. Yet recently published economic programme of the social-democratic government of Germany prepared by Finance Minister Mr Oskar Lafontain suggested for a new appraisal of the chances for the EU absorption of CEE countries.

The main economic problem in Germany is the high unemployment level, i. e. production capacities are not fully utilised. The coalition government of the greens and social-democrats did not invent anything better than to propose classic Keynessian methods of triggering demand led growth by means of enhancement of volumes of recourses redistributed through the state budget which should cause an increase in consumption, aggregate demand and GDP. The budget revenues are to be increased by imposing new taxes on business including a new ecological tax. Yet these measures can lead to the outflow of capital to other EU countries and most likely — to newly absorbed members which welcome foreign investments and have mach less strict tax regulations.

Having discussed this possibility Mr Schroeder's government decided to alter its opinion towards the accession of new members to the EU, amongst the forerunners usually mentioned Poland, Hungary, the Czech Republic, Slovenia and Estonia. The idea of the EU widening was substituted with the concept of deepening i. e. allocating more attention and recourses to internal economic and social issues of the EU states. Taking into account the influence Germany has in the EU and the fact that poorer EU members have been traditionally sceptic to the idea of the absorption because the new members can cut into the pie of structural and agricultural transfers one can easily predict slower pace of the EU enlargement.

For Ukraine this alteration can lead to the complication of gaining the EU associated member status and possible increase in pressure towards the integration within the CIS.

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